THE CHANGING ROLE OF IA
KEEPING WATCH FOR THE BOARD

PROGRESS THROUGH SHARING

STRATEGIC PARTNER

The Institute of Internal Auditors Singapore
AN IIA-SAC ROUNDTABLE DISCUSSION ON MAY 23, 2014, SINGAPORE

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INTRODUCTION
A CHANGING ROLE
“In the past, IA was the eyes and ears of management. This was the traditional role of IA. But after Enron and other major corporate failures, regulatory authorities have shifted the responsibility of governance to the Board. IA now becomes the eyes and ears of the Board.” – Professor Teo Chee Khiang

The economic and regulatory landscape has evolved dramatically over the last decade. Risks have become more far-flung and pervasive, while control lapses are potentially more ambiguous and occur at higher levels. Boards and stakeholders need independent assurance more than ever before.

But at the same time, internal audit, the provider of assurance, is undervalued by the same people who should rely on it. IA is seldom granted high standing within organisations. Instead, it is often undervalued and under-resourced.

Faced with an increasingly complex business environment, IA needs to re-examine its role and evaluate its position in relation to other stakeholders. At the same time, boards and management need to up their game and be more informed in their use of IA.

To gain insights into how this can be accomplished, the Institute of Internal Auditors (IIA) Singapore, in strategic partnership with the Singapore Accountancy Commission, organised a roundtable to bring together key stakeholders for a discussion of IA’s stand in the changing environment. The roundtable was held in May 2014 and participants included top individuals from the regulatory, oversight, professional, business and academic fields.

This report summarises the key points brought up during the roundtable.
WHO DOES WHAT?
THE ROLES OF IA, THE BOARD & MANAGEMENT
“We are not above or below the CFO. We are the Internal Audit function and we report to the Audit Committee. We are the only ones who are seen as independent; and we should be proud of that lineage and play our role.” — Mr. Uantchern Loh

IA: The Independent Assurer

IA’s primary role is that of an independent assurer, providing the board with assurance that controls exist and are working as they should. Its other significant role is that of an independent business advisor to management. As such, IA may focus on any of several different areas including:

- Internal controls
- Governance structure
- Operational efficiency and effectiveness
- Fraud risk management
- Value for money

Within its area of focus, IA’s responsibility is to provide independent, objective assurance and consulting activity to add value and improve the organisation’s operations. The board will review the adequacy and effectiveness of the risk management and internal control systems; and comment on this in the Annual Report.
To help organisations to accomplish their objectives, IA needs firstly a solid understanding of the organisation’s business imperatives, so that it can align its IA strategy with the business strategy. Secondly, it needs the support of both the board and management. The board must determine IA’s area of focus before IA can begin work, while management must cooperate with IA so that it has all the necessary information to make its assessment.

“From internal audit’s standpoint, our responsibility would be to carry out a proper risk assessment. We need ask ourselves whether we have looked at the business as a whole. We also need to enhance our business acumen to understand the business objectives and the process controls at various levels.”
— Mr. Ishan Sen

“Not only does internal audit need to up its game, the stakeholders that rely on internal audit need to up their game as well. They need to play their part. And I think that is a challenge in many boards in Singapore.”
— Mr. Ng Siew Quan
The Board:
Providing direction

The Singapore Code of Corporate Governance (Principle 11) states that the board is responsible for governing risk. As such, the board is IA’s main stakeholder and must set IA’s direction by specifying the areas IA should look at. In this, the board may be influenced to some extent by shareholder demands.

The board must ask IA the right questions in order to understand the risks, ensure that a system of controls exists to manage risk, and ensure that the system is functioning. The board must also engage management to ensure that policies are properly executed.

Within the board, the audit committee plays the role of directing and supporting IA. The Code of Corporate Governance calls for the Audit Committee to have adequate resources and has appropriate standing within the company. The AC approves the hiring, removal, evaluation and compensation of the Head of IA. The audit committee’s focus becomes IA’s mandate.

Because of the crucial role the board plays in setting IA’s direction, its composition and competence make a great difference to IA’s ultimate effectiveness. A highly competent board will result in an equally high-performing IA function, but a less competent board will dilute the IA function’s performance.

“The board and the audit committee play a crucial role in determining the direction of what IA eventually does. They must set the direction of IA.”
— Professor Teo Chee Khiang
Management: Designing & implementing policies

Day to day operational control resides with management. As such, management is responsible for executing the directions of the board and reporting on what was done and the outcome. This also requires a divide between management and the board: management should be a minority on the board so that the independent directors can properly review the performance of management in meeting agreed goals and monitor the reporting of performance.

In addition to the above, both the board and senior management are responsible for setting tone from the top. An organisation’s culture of corporate governance will strongly influence the IA function’s ability to carry out its duties.

“The board’s role is essentially to direct and lead, but management has to execute. IA is the independent check and balance.”
— Mr. Gautam Banerjee

“I think that the question really is the quality of the people that are actually charged with doing this. Not only the internal auditor, but also the boards.”
— Mr. Ng Siew Quan

“If you have a board where four members are from management and three members are independent — I think you’ve lost the battle. In such a case it’s almost impossible for independent directors to have board influence which will be of any impact.”
— Mr. Gautam Banerjee

“The relationship between internal audit and management is a partnership model, albeit one marked by very strong independence.”
— Mr. Winston Yean
THE WIDENING EXPECTATION GAP OF STAKEHOLDERS
IA’s role and purpose are often misconstrued by the very people who should rely on it. The PwC 2014 State of the Internal Audit Profession Study found that globally more than half (55%) of senior management feel that IA does not add significant value. IA is frequently viewed as a fault-finder and criticised for not contributing to the bottom line, although that is not its job in the first place.

However, this negative view of IA may arise from that same misunderstanding. For example, the board may set IA tasks that it is not positioned to complete, or management may demand answers that IA is unable to provide. At other times, the expectation gap arises from conflicting demands, where IA is unable to meet the needs of all its stakeholders. Quite frequently, IA is also hampered by a lack of resources.

This often becomes a vicious cycle. IA is given a much narrower scope in many organisations, while management may be reluctant to work with it. IA’s lack of resources may also stem from the understanding of its role. For example, it is seen as a dead-end position and has difficulty attracting talent.

“I think we suffer a bit from a historical brand and perception which compartmentalises internal audit into a very narrow field of service. Whereas internal audit has the potential to go everywhere, speak to everybody; get perceptions of individuals, culture and behaviour. But we rarely get asked those questions by the board.”
– Mr. Graham Macnaughton
IA’s involvement – Most times, a little too late

IA’s interaction with day to day operations and strategic discussions is often minimal. Sometimes, IA may not be aware of control lapses in strategic projects as well as daily operational processes or initiatives to address these. From management’s perspective, this may look as if IA is not picking up on strategic and operational issues that it should be aware of.

Furthermore, an overly powerful IA function may have undesirable outcomes: either it creates a culture of rigidity and excessive focus on compliance at the expense of efficiency and innovation, or creates an environment of resentment as people feel they are being constantly faulted.

“I think it’s important for senior management and especially the auditees at the operational level, to understand the role of internal audit. Otherwise, misunderstandings would render the IA function less effective.”
— Ms. Debbie Goh
Conflicting stakeholder demands

The board and management have different expectations, which often lead to a misunderstanding of IA’s role. The board and audit committee need IA to provide assurance on a satisfactory governance structure and good internal controls, and to them, if IA can say definitively that controls exist or that there are no issues, that is value-add.

Management’s priority, however, is the bottom line and management may assess IA’s value-add in terms of its contribution to the bottom line, which is not easily quantified. In some cases, management may feel that control weaknesses are small routine matters and that IA should go beyond merely identifying them.

“My preoccupation as a board member and as an audit committee member is to make sure as a basic requirement that assurance is given to me. And if the internal auditor comes to me and tells me that there are controls, that is value add to me. But to some management, value add may only mean improving on efficiency and effectiveness of operations. This could only be possible when internal audit is given adequate resources in quality and quantity.”
— Professor Teo Chee Khiang

“From a management perspective, I do not need internal audit to tell me about issues of minor process compliance or occasional human error. I need them to tell me about the systemic errors and weaknesses, the major risks on the horizon that can have a devastating impact on my part of the operation and the business as a whole.”
— Mr. Winston Yean
IA needs to be pro-active in engaging what its stakeholders want and take the lead in addressing their needs. This was highlighted by IIA Global President and CEO Richard Chambers in a recent Business Times article 16 May 2014, where he suggested that IA should not wait to be told what to do. He was quoted as saying:

“Good business leaders should be a step ahead of what customers want, and good auditors often need to be a step ahead of management. This is a challenging proposition, and it can only be accomplished when needs and expectations are clearly communicated.”
IA’s struggle with limited resources

In many companies, IA has insufficient resources to be allocated in more than one or two directions. However, the board’s choice of direction may differ from management’s. For example, the board may want IA to look into governance but management may be concerned about operational efficiency. As the board is IA’s primary stakeholder, IA has to prioritise the board’s direction and may not be able to address management’s needs at the same time. This contributes to the expectation gap.

“You have to work your audit plan against the resources that you have and the quality of those resources… Resource limitations are in reality, a struggle for many in the industry.”
– Ms. Debbie Goh

The IIA Audit Executive Center 2011 Emerging Trends Survey Report offers insights into the strategies audit executives commonly deploy to assess stakeholder expectations:

1. Ongoing informal discussions between the chief audit executive and the audit committee chair to assess expectations 69%
2. Regular formal meetings between internal audit and key stakeholders to assess expectations 60%
3. Discussions between internal audit and the full audit committee to assess collective expectations 56%
4. Formal surveys of internal audit stakeholders to assess expectations/performance 40%
5. Discussions with the full executive leadership/management team in the same room to assess collective expectations/performance 29%
FRAUD
EVERYONE’S RESPONSIBILITY
Fraud presents a very great risk to organisations today, and IA, as a provider of independent assurance, has the positioning and the responsibility to identify fraud risk. It is very effective at doing so: the biennial Association of Certified Fraud Examiners (ACFE) Global Fraud Study has consistently found IA to be among the top three methods of detecting fraud.

With the changing nature of fraud today, IA’s part in fraud identification and prevention looms even larger. Fraud is still fundamentally an outcome of failure, but it now encompasses anything that confers an unfair advantage, not just upon an individual but upon the organisation as a whole. This includes accounting fraud: the presentation of a false image, with benefits no longer directly linked to the fraudulent activity.

“The internal auditor has a massive role to play in the fraud framework, but fraud really is everybody’s responsibility in an organisation.” — Mr. Graham Macnaughton

“Fraud ultimately is an outcome. And why is there an outcome? It’s because of the failure of internal controls and unguarded opportunities.” — Mr. Ng Siew Quan
IA’s role in addressing fraud risk

IA is responsible for fraud risk assessment: determining whether an organisation is more susceptible to fraud because of factors such as its industry, geography or even the demographic of its employees. Having made this assessment, IA is further responsible for ensuring that the board understands the risk.

While conducting audit engagements, IA is generally expected to keep a lookout for potential ‘red flags’ or unusual transactions. The use of data analytics often assists IA to extend the coverage substantially and identify specific patterns or trends which could be unusual. However, IA’s fraud detection role should stop there. IA should not actively seek out fraud. Doing so runs the risk of narrowing its focus and alienating employees.

Management’s responsibility

Management is responsible for detecting, preventing and mitigating fraud. Firstly, IA’s presence does not exempt management from taking ownership of risk. If management is aware of control lapses or areas for improvement, management should address these issues as they happen, rather than waiting for IA to bring them up during the audit period.

“We should champion the baseline of defence to the management, so that the company is able to have proper governance. But at the same time we should not compartmentalise ourselves into the third line.”
— Mr. Eric Lim

“Fraud prevention is management’s role. All of the measures to prevent fraud are clearly management’s responsibility.”
— Mr. Gautam Banerjee
Secondly, management’s role is to implement policies. That includes fraud management policies, whether developed by the board or by management itself in response to IA’s findings.

The Board’s responsibility

Under the Singapore Code of Corporate Governance, the board is responsible for the governance of risk, including fraud risk. The board must first decide what controls are appropriate for the organisation, and then direct management to implement the controls. Once that is done, the board must follow up with management to ensure that the system is working as intended.

With today’s potential for fraud to occur at senior levels, the board must also take additional measures to verify management’s work. This may require the independent directors to engage with both external and internal auditors and obtain an objective assessment of management’s quality, ethics and values.

“Anything that people do that confers an unfair advantage comes under the banner of fraud. So things that people might have thought were standard business practices may be close to the edge.”
— Mr. Graham Macnaughton

“I don’t think we should say that internal audit should look at fraud, because the moment you do that, first of all you will not be welcome, and secondly, you will be too invasive into the normal operations of the business. And that’s not the role of internal audit. You want to be felt without being in the way.”
— Mr. Ng Siew Quan

“I may not do wrong but if I don’t do right, is that ethical? Is it tantamount to fraud? If I do not disclose this, you may not make the right decision. So for management, the board, the line people, we don’t have to do wrong but if we don’t do right, I think that amounts to fraud because it’s ethically not right.”
— Mr. Uantchern Loh
A GLIMPSE OF THE FUTURE
BUILDING BLOCKS FOR SUCCESS
“IA has to think big to bring in the value. If we don’t think big, we will always be in the basement.” — Mr. Uantchern Loh

If IA is to gain a broader purview and fulfil greater responsibilities, it needs to find ways to add value to its work. It needs to work with the board and management to clearly define its assurance role and improve its standing within the organisation.

Given that IA’s advisory role is increasingly sought after by management, IA may also expand the support it offers in this area. However, as IA is ultimately accountable to the board, it should be objective and give careful considerations about making recommendations in order to minimise conflict of interest.
Proactively engaging the board & management

At times, the board and audit committee may not be fully informed about IA’s role or how it functions. The onus is therefore on IA to engage and educate the board on what IA can and cannot do, and how IA can be of greatest help to them. If need be, IA should independently propose its own work plan, based on its understanding of the board’s needs, rather than accommodating every charge laid on it by the board and audit committee.

IA also needs to engage management regularly in order to understand the business of their organisation. With that understanding, IA will be better able to identify challenges and opportunities, assess points of risk, and advise management upfront rather than providing input only after incidents have happened. More importantly, IA needs to rise above compliance and work with management to identify major issues, systemic risks and errors that affect the entire business.

“I believe it’s an education process. It’s not just expecting the audit committee members to rise to the occasion, but also for us as internal auditors to educate them on the role of internal audit and potentially remind the Board and the audit committee that the internal audit is a third line of defence. In engaging the audit committee and management, it is important to impress upon them our roles and how we perform our functions.”
— Ms. Debbie Goh

“We should develop internal audit’s capability and capacity, give it adequate resources to do what we want it to do. And we should also let internal audit sit at the table and know the business so that it can help. If internal audit doesn’t know the business, there’s no way it could help.”
— Mr. Eric Lim
Becoming an “integrity station”

IA has the potential to become an “integrity station” for strategic decisions. As an independent assurance provider, IA ensures that the information upon which the board bases decisions is reliable.

For this purpose, it is extremely important to preserve IA’s independence and objectivity, and minimise conflicts of interest. For example, the head of IA’s performance appraisal, career progression and salary package should not be determined solely by management, and he or she should not be on a career path that will place him or her in a management position.

IA will need direct access to the board and audit committee in this role, ideally including a permanent presence as an observer at the board. IA will further need to form strategic partnerships with other departments, so as to access the information it needs and which may be of interest to the board. For example, IA typically faces resistance when examining areas such as remuneration and incentives, and partnering with HR may address this difficulty.
Raising IA’s status

The Code of Corporate Governance specifically states that IA must “have the right standing” to do its job. IA in Singapore needs more status and respect, so as to gain the cooperation of other departments and do its job more effectively. However, respect is not easily earned: it arises from credibility, which comes from having deep knowledge of the business, which in turn comes from having access to information gained through cooperation. Furthermore, organisations may not be willing to pay a premium for a head of IA who has sufficient standing.

One solution is to introduce the concept of the general auditor, which is used by some US companies. The general auditor is typically a very senior individual invited from outside the company to provide high level independent assurance. He or she attends board meetings and is placed on par with the C-suite, but not within it. Due to this status, the general auditor’s presence provides the company’s IA with additional visibility and standing.

“We need to give internal audit more status in Singapore… If you have a certain standing, you will be given that much more respect and people will cooperate with you more. It should enable you to play your role better.”
— Mr. Gautam Banerjee

“I think we have to be all things to all people, and first of all we must believe that we have a key role to play at the table. Otherwise, we’ll always be in the basement. And secondly, we must be brave enough to go to the owners or the board and say: ‘What do you really want to do?’”
— Mr. Uantchern Loh

“The status of internal audit and recognition of its value in an organisation are key success factors for IA and this has to be set by the board and the audit committee, and accepted by senior management.”
— Ms. Debbie Goh
Getting the right people into IA

IA’s need for top talent is pressing and will affect its ability to add value to the organisation. A possible solution, already practiced by some large organisations, is to implement a mechanism whereby top individuals from various departments, excluding the C-suite, are rotated through IA. For example, IA could be a compulsory part of companies’ Talent Development programme for promising individuals in the organisation. This has several benefits: it will raise the competence of IA, increase its connections with the rest of the organisation, and provide other departments with a better understanding of IA’s work and the control environment.

Such a move requires IA to be seen as a desirable posting in the first place. It also needs tone from the top to work: it must be driven by the board and audit committee, and fully supported by management. Otherwise, it is likely to face resistance at departmental level.

“IA’s role must be strategic and value-adding to the enterprise to be able to attract organisational talents and add positively to their credentials, such that a stint in IA would be well-regarded both by management and by the candidates themselves.”
— Mr. Winston Yean

“The head of internal audit must have a certain standing, and his career progression and salary package must be set up in such a way that he can do his work without any fear or favour. I think that’s quite fundamental.”
— Professor Teo Chee Khiang

“Is internal audit proactively engaging management, understanding the business and the challenges of the business, knowing where are the risk points and so on, so that they can actually advise management upfront? Stakeholders like the board and shareholders are demanding that.”
— Mr. Ng Siew Quan
CONCLUSION
THE ROADMAP TO SUCCESS
In response to the changing economic environment, IA will need to evolve over the next few years. IA’s primary role is still assurance and it remains accountable only to the board, but within these parameters, IA must broaden its scope and improve its capabilities, with the ultimate goal of increasing the overall value it provides to an organisation.

Some key conclusions are:

**IA must actively engage with its stakeholders**
IA needs to work closely with the Board, AC and Management, so as to gain their support and collaborate with them in the formulation of a clear direction. In doing so, it must educate the Board, AC and Management on its role and how it can best assist them. IA also needs to work in close partnership with other functions and avoid isolation or compartmentalisation.

**IA needs to be positioned as an attractive function**
The head of IA should have a certain standing, similar to the status of a general auditor, and his positioning and role has to be very clear. IA should also be given adequate resources. This will help it to better develop and nurture talent.

**IA needs to hone specific capabilities for the future**
These capabilities should not be just technical skills. They should also include soft skills such as business acumen, leadership, and most importantly, communication skills.
IIA Singapore and SAC thank the participants of this roundtable discussion for sharing their valuable experiences and insights:

**FRONT ROW (L–R)**
- Mr. Gautam Banerjee  Audit Committee Chairman, The Straits Trading Company Ltd
- Mr. Eric Lim  President, IIA Singapore
- Mr. Uantchern Loh  Chief Executive, Singapore Accountancy Commission
- Mr. Edward Ta  Lead Financial Controller, Cargill International Trading Pte Ltd, Singapore

**BACK ROW (L–R)**
- Ms. Melissa Aw Yong  Board Member, IIA Singapore *(Moderator)*
- Mr. Graham Hay Macnaughton  General Manager Audit, International and Institutional Division, ANZ Bank
- Ms. Debbie Goh  Head, Group Internal Audit, Fraser & Neave Group
- Mr. Ishan Sen  Director, Group Internal Audit, Singapore Telecommunications Limited
- Mr. Ng Siew Quan  Partner, PricewaterhouseCoopers LLP
- Mr. Winston Yeaw  Director (Finance & Planning), Central Provident Fund Board
- Professor Teo Chee Khiang  Professor (Practice), NUS Business School, Audit Committee Chairman, CPF Board, Retired Deputy Auditor-General, Singapore
ABOUT IIA SINGAPORE

The Institute of Internal Auditors (IIA) Singapore is a professional organisation dedicated to the advancement and development of the internal audit profession. Established in 1976, members of IIA Singapore belong to a global community of more than 180,000 professionals in over 190 countries who share a common vision to advance their professional growth in internal auditing and add value in their organisations.

Our 2,300 members work in internal auditing, accounting, risk management, governance, compliance, internal control, information technology audit, education, and security.

ABOUT SAC

Established in April 2013 as a statutory body of the Singapore government, the Singapore Accountancy Commission (SAC) is the lead agency in spearheading the development of the accountancy sector in Singapore.

The SAC’s Vision is for Singapore to be the Leading Global Accountancy Hub. This will be achieved through developing for Singapore a vibrant accountancy sector that enables the economy to grow, businesses to thrive and talent to flourish. In fulfilling this mission, the SAC seeks to uphold the values of being relevant, insightful, collaborative and advocative.
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